No. 80-1373

IN THE

Supreme Court of the United States

UTILITY CONSUMERS COUNCIL OF MISSOURI, INC.,
Petitioner,

v.

PUBLIC SERVICE COMMISSION OF MISSOURI, and
UNION ELECTRIC COMPANY,
Respondents.

JOINT BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

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QUESTIONS PRESENTED FOR REVIEW

In the first of its two questions presented for review, Petitioner states that certain taxes "are known to be non-existent". (Petition, p. i). That statement is not correct. As discussed more fully in Respondents' "Statement of the Case", the only question is *when* certain tax benefits should be recognized for ratemaking purposes. Actually, the question raised here by Petitioner involves the now familiar issue of "normalization" versus "flow-through" of tax benefits.

Petitioner's second question for review also includes the inaccurate implication that the utility rates in issue include taxes which will never be paid.

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TEXT OF LAWS RELIED UPON

Constitution of 1945 of the State of Missouri, as Amended, Article 5, Section 3:

> **§ 3. Jurisdiction of the supreme court**
>
> Section 3. The supreme court shall have exclusive appellate jurisdiction in all cases involving the validity of a treaty or statute of the United States, or of a statute or provision of the constitution of this state, the construction of the revenue laws of this state, the title to any state office and in all cases where the punishment imposed is death or imprisonment for life. The court of appeals shall have general appellate jurisdiction in all cases except those within the exclusive jurisdiction of the supreme court. (Amendments adopted at special elections Aug. 4, 1970 and Aug. 3, 1976; proposed by Laws 1969, p. 588 and Laws 1976, p. 804)

Section 386.500(2) Revised Statutes of Missouri 1978:

> 2. No cause or action arising out of any order or decision of the commission shall accrue in any court to any corporation or the public counsel or person or public utility unless that party shall have made, before the effective date of such order or decision, application to the commission for a rehearing. Such application shall set forth specifically the ground or grounds on which the applicant considers said order or decision to be unlawful, unjust or unreasonable. The applicant shall not in any court urge or rely on any ground not so set forth in its application for rehearing. (Laws 1913, p. 640, as amended by Laws 1977, p. 595, Sec. 1)

Section 512.050 Revised Statutes of Missouri 1978:

When an appeal is permitted by law from a trial court and within the time prescribed, a party or his agent may appeal from a judgment or order by filing with the clerk of the trial court a notice of appeal. No such appeal shall be effective unless the notice of appeal shall be filed not later than ten days after the judgment or order appealed from becomes final. After a timely filing of such notice of appeal, failure of the appellant to take any of the further steps to secure the review of the judgment or order appealed from does not affect the validity of the appeal, but is ground for such action as the appellate court deems appropriate, which may include dismissal of the appeal. The docket fee of ten dollars in the appellate court shall be deposited with the clerk of the trial court at the time of filing the notice of appeal. (Laws 1943 p. 353 § 129)

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OPINION BELOW

The retyping of the Missouri Court of Appeals' opinion included in Petitioner's Appendix A includes a number of typographical errors. Most of those errors appear to be insignificant. However, Respondents respectfully suggest that anyone wishing to read the opinion below should refer to the reported decision at 606 S.W.2d 222. Alternatively, a list of the changes required in Petitioner's Appendix A is shown in Appendix I of this Brief.

STATEMENT OF THE CASE

Petitioner's "Statement of the Case" includes several allegations which are inaccurate and for which there is no support in the record. First, Petitioner states that "the Respondent Company included certain items of income tax expense which it knew would not have to be paid", and that "It is not disputed that these taxes will not have to be paid..." (Petition, p. 4). At best the contention that the taxes will not be paid is mere argument, and should not have been presented as fact in Petitioner's "Statement of the Case". Even more disconcerting are Petitioner's statements that its allegations in this regard are known to be true, and "not disputed". Respondents have in fact disputed these and similar claims throughout these proceedings, and the sole reference by Petitioner to the Commission transcript pages 792-806 does not support its allegations. The content of those pages is set forth in Appendix II hereto, and consists of certain direct and cross-examination of the Commission Staff witness Mr. Bradley R. Lewis. As Mr. Lewis indicates in answer to the first question on cross, the issue here is whether to pass certain tax benefits on to utlility customers immediately, or to "defer" or normalize them over a period of years. The question is merely one of timing. Mr. Lewis does not state that the "taxes will not have to be paid".

Next, at page 6, Petitioner states as follows:

> Petitioner has contended throughout that allowance of non-taxes amounts to a confiscation of the ratepayers property and a violation of the Constitutional ratemaking standards repeatedly enunciated by this Court, and that the Internal Revenue Code provisions which penalize the utility companies if the regulatory commissions set lawful rates by excluding non-taxes are beyond the legitimate powers of Congress.

As more fully developed in part I of the Argument section of this Brief, Petitioner in fact has not made these contentions "throughout" the proceedings below.

Finally, at pages 6 and 7 Petitioner states with respect to the above-quoted arguments that "The PSC and the Circuit Court did not rule specifically on the questions". As discussed hereafter, these questions were never raised by Petitioner before the PSC. They were raised before the two courts below, at least in different forms, and were addressed in the final opinion below to the extent necessary for their resolution. (See Petitioner's Appendix A-9, A-11 through 14; 606 S.W.2d at 225-226)

The inclusion in a "Statement of the Case" of what at best amounts to mere argument is directly contrary to the Court's Rule 23. Moreover, Petitioner has almost if not completely ignored the requirements of Rule 23(1)(f) with respect to detailing the method by which it raised below the federal questions presented here for review. These defects alone are sufficient reason for denial of the Petition. Rule 23(4)

ARGUMENT

I.

Petitioner Failed To Preserve The Two Questions Raised Here For Review.

Petitioner has raised two questions for review: (1) whether the Respondent Commission's treatment of utility tax benefits for ratemaking purposes is in violation of due process and equal protection requirements; and (2) whether certain conditions established by the Federal Internal Revenue Code on the availability of such tax benefits constitute an unconstitutional invasion of the powers reserved to the States under the Tenth Amendment to the United States Constitution. Neither issue was properly preserved by Petitioner during the proceedings below, and thus the Petition should be dismissed.

In the rate case hearings before the Respondent Public Service Commission, the treatment of the tax benefits in question was scarcely at issue. The *only* testimony offered by Petitioner (or any of the other parties) in opposition to "normalization" was this passing reference in the prepared statement of its one witness: "We also oppose certain matters relating to rate base, income and operating expenses in the Company's filing, in particular the normalization or allowance of tax expenses which are not incurred with relationship to the test year". (UCCM Exhibit 1, p.1). This near-complete lack of a factual record regarding the issues now raised by Petitioner no doubt explains why it must now rely almost totally for its factual support on a law review article written by counsel for the Petitioner. (Petition p. 8-9)

More significantly, the two issues raised here by Petitioner were not presented to the Respondent Commission in Petitioner's Motion for Rehearing. Under Missouri law, matters not raised in the Motion for Rehearing are not preserved for judicial review. Section 386.500(2) Revised Statutes of Missouri 1978;

State ex rel. Kansas City Transit, Inc. v. *Public Service Commission,* 406 S.W.2d 5, 7 (Mo banc 1966). The only section of Petitioner's Motion for Rehearing dealing with the issue of "normalization" was paragraph 7, which is set forth in Appendix III hereto. Appellant did allege in this Motion that normalization violated the Commission's "statutory and constitutional" duty to the ratepayers. However, with respect to the isues raised here Petitioner made absolutely no mention of the Due Process or Equal Protection clauses, or of the Tenth Amendment. And to preserve a constitutional issue in Missouri, "the sections of the Constitution claimed to have been violated must be specified." *State ex rel. Williamson* v. *County Court of Barry County,* 363 S.W.2d 691, 694 (Mo 1963). Therefore, the issues raised here by Petitioner were not properly preserved for review.

After the Commission's order was affirmed by the Circuit Court of Cole County, Missouri, Petitioner then appealed to the Missouri Court of Appeals. (Petition, p. 3). Under Missouri law, the filing of a "Notice of Appeal" is a jurisdictional prerequisite for taking the appeal from the Circuit Court to the Court of Appeals. Section 512.050, Revised Statutes of Missouri 1978. Although Petitioner is now alleging that certain provisions of the Federal Internal Revenue Code are unconstitutional, its Notice of Appeal to the Missouri Court of Appeals, set forth in Appendix IV hereto, specifically stated that "This appeal does *not* involve the validity of a . . . statute of the United States." (emphasis added) In fact, the Missouri Court of Appeals has no jurisdiction to rule on the validity of a United States statute. The state Supreme Court has exclusive appellate jurisdiction in all such cases. Missouri Constitution, Article 5, section 3, as amended.

For the above reasons, Petitoner failed to develop and preserve the two questions raised here, particularly the issue regarding the unconstitutionality of the Internal Revenue Code. Its Petition should therefore be dismissed.

II.

Petitioners First Question For Review Does Not Involve A Federal Question Of Substance Not Heretofore Determined By This Court, Or Decided In A Way Contrary To Applicable Decisions Of This Court.

Petitioner's argument for accepting review of its first question, dealing with the Due Process and Equal Protection issues, is set forth at pages 8-13 of the Petition. In an apparent attempt to bolster the significance of these issues, Petitioner relies upon certain alleged facts for which it cites as authority only a law review article written by Petitioner's attorney. (Petition, p. 8-9). Those allegations are inaccurate, and find absolutely no support in the record in this case. In any event they do not even purport to apply to this particular proceeding.

At page 9, referring to "normalization" of the tax benefits in question, Petitioner then claims that "This Court has never ruled on the serious legal questions as to the validity of this practice". While this Court may not have decided the exact issues raised here by Petitioner, it has in fact approved the "normalization" treatment of utility tax benefits. In *Federal Power Commission* v. *Memphis Light, Gas and Water Division,* 411 U.S. 458 (1973) the precise issue addressed by the Court was whether the Federal Power Commission was precluded by law from allowing a utility to adopt normalization for ratemaking purposes. The Court held that normalization is permissible, which conclusion was based in part at least upon the wide scope of authority generally granted to the Commission in calculating tax expenses for ratemaking purposes. 411 U.S. at 466-467. On remand of this decision the Court of Appeals then concluded as follows:

> "...there is the logical fact that normalization causes current consumers to pay their fair share of tax costs attributable to depreciation, so that future consumers will not be forced to pay higher tax costs when the basis for

depreciation declines. Normalization effects a stabilization in rates between present and future consumers, insofar as rates reflect depreciation."

. . .

"We find no conflict between the rate increase allowed Texas Gas and the 'actual expenditures theory' by which rates of utilities are supposed to reflect actual payments. For while Texas Gas is not currently paying taxes at straight-line rates, it is incurring the liability now to pay increased taxes in the future. Such a method as normalization, whereby current consumers are prevented from forcing future consumers to pay their deferred taxes, does not amount to causing an increase of rates based on fictitious taxes." *Memphis Light, Gas and Water Division* v. *Federal Power Commission,* 500 F.2d 798, 806-807 (Dist. of Columbia Circuit, 1974).

In addition to these two cases, the Missouri Court of Appeals relied upon a number of other Federal and state Courts which have approved normalization. (See Petitioners Appendix A-10, 16, 18; 606 S.W.2d at 225, 226, 227) In contrast, Petitioner has not referred this Court to a single decision which has disallowed normalization. As is apparent, the issue raised here by Petitioner falls far short of the Court's criteria for accepting review of state court decisions. Rule 19(1)(a).

III.

Petitioners Second Question For Review Does Not Involve A Federal Question Which Was Determined In A Way Contrary To Applicable Decisions Of This Court.

Petitioners second question, involving the constitutionality of the Internal Revenue Code, is addressed at pages 14-18 of the Petition. The main thrust of Petitioner's argument is that the tax laws in question would deny certain tax benefits to a utility if those benefits were not normalized, and that inasmuch as the

laws produce no tax revenue, they therefore constitute an invasion of the powers reserved to the states by the Tenth Amendment. (Petition, p. 14-16).

It should be noted first, as Petitioner earlier conceded, that under Federal tax law the availability to a utility of one of the three types of tax benefits is totally independent of state Commission treatment of that tax benefit. (Petition, p. 6). Therefore, the question presented by Petitioner with respect to Federal interference in state utility regulation applies at best to only two of the tax benefits referred to by Petitioner. Also of a preliminary nature, Petitioner's second argument also includes several allegations totally unsupported by the record. Among them: the claim that the tax laws in question "throw the state regulatory process into chaos making the state proceedings unreviewable and ridiculous" (Petition, p. 15); and that "The Court below was reluctant to involve itself with these issues because of what it perceived as administrative complexity" (Petition, p. 17).

On the merits, Petitioner has failed to demonstrate that the Missouri Court's decision is not in accord with applicable decisions of this Court. In the first place, before the Missouri Court the Petitioner had argued that the sections of the Internal Revenue Code in question *required* normalization of the tax benefits. (See Petitioner's Appendix A-13; 606 S.W.2d at 225). The Court of Appeals disposed of the issue by finding that the tax laws in fact do *not* require normalization - a conclusion with which Petitioner now claims to agree (Petition, p. 14). Therefore, by Petitioner's own admission the Missouri Court correctly decided the issue as presented to it by Petitioner.

Even assuming that Petitioner had argued below that the tax law encourages but does not require normalization, Petitioner still has not demonstrated that those laws conflict with applicable decisions of this Court. One basic error is that Petitioner apparently assumes that a tax law achieving non-tax pur-

poses must produce tax revenue in order to be lawful. If that were the case, then other tax deductions furthering such purposes as education and home ownership would likewise be unlawful. Such deductions are specifically designed *not* to produce additional tax revenues. In none of the cases cited by Petitioner at page 15 did this Court hold that a tax law achieving non-tax purposes must produce additional tax revenue. Moreover, even if increased tax revenue is a prerequisite of a valid tax law, that test would in fact be met here. IRC section 167(1) was passed as part of the Tax Reform Act of 1969, Pub. L. No. 91-172, sec. 441, 83 Stat. 625. The accompanying Congressional Reports indicate that this section was intended in part at least to stem the losses in tax revenue resulting from flow-through treatment by some commissions of the tax benefits associated with accelerated depreciation. H.R. Rep. No. 413, 91st Cong., 1st Sess. 132, reprinted in 1969 U.S. Code Cong. & Admin. News 1645, 1782; S. Rep. No.552, 91st Cong., 1st Sess. 132, reprinted in 1969 U.S. Code Cong. & Admin. News 2027, 2204. These same considerations would be applicable also to flow-through treatment of the investment tax credit.

The Court's most applicable pronouncement on the limitations imposed by the Tenth Amendment is *National League of Cities* v. *Usery,* 426 U.S. 833 (1976), wherein the Court ruled unconstitutional the application of federal minimum wage laws to state and local government employees. That case does not support the argument raised here by Petitioner. The distinguishing factor in *National League of Cities* was the Court's finding that the law in question would have a disruptive impact upon government employment practices. *Id* at 846-852. In the present case there is no evidence to support a finding that the tax laws in question have caused any problems whatsoever in state regulation of public utilities. Absent some finding that the federal law has caused a significant disruption of state or local government, *National League of Cities* is inapplicable. Moreover, unlike the minimum wage provisions at issue in *Na-*

tional League of Cities, the tax laws in question here admittedly do not mandate any particular action on the part of state government. (Petition, p. 14) Therefore, none of the decisions cited by Petitioner support its claim that the Internal Revenue Code violates the Tenth Amendment.

IV.

Petitioner Does Not Have Standing To Challenge The Tax Laws On Tenth Amendment Grounds.

The complete lack of evidence in this case regarding a disruptive impact from Federal tax law on state utility regulation leads to one further ground for rejecting Petitioner's Tenth Amendment claim. There is no evidence here of any disruption of state utility regulation in part no doubt because the state is not contending that its regulation is being disrupted. The party making this claim, i.e. the Petitioner, is a private organization which represented certain private interests in a utility rate case (Petition, p. 3). It has no standing to speak for the State of Missouri. To the extent the state is represented here it is through the Respondent Public Service Commission, which opposes Petitioner's position. Respondents therfore contend that the Petitioner does not have standing to raise the Tenth Amendment claim embodied in the second question presented here for review. *California Bankers Association* v. *Shultz,* 416 U.S. 21, 44 (1974).

CONCLUSION

For the foregoing reasons, Respondents Public Service Commission and Union Electric Company respectfully pray that the Court deny the Petition for Writ of Certiorari.

Dated: March 12, 1981

Respectfully submitted,

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APPENDIX

APPENDIX I

List Of Typographical Errors in Petitioner's Appendix A

1. A-2, line 13, change "differences" to "difference"
2. A-4, line 6, change "not" to "now"
3. A-6, line 3, after "method" add the following: "been used in figuring the income taxes. For the test year now under examination, the accelerated depreciation method"
4. A-7, line 16, change "basis" to "basic"
5. A-8, line 15, change "insures" to "inures"
6. A-9, line 3, change "364 N.F.2d 869" to "364 N.E.2d 869"
7. A-9, line 22, change "that" to "concerning"
8. A-10, line 2, after "*Id.*" add "364 N.E.2d"
9. A-10, line 7, after "411 U.S. 458" add "93 S.Ct. 1723, 36 L.Ed.2d 426"
10. A-10, line 11, change "597 F.2d 586" to "597 P.2d 586"
11. A-10, line 12-13, after "*Commission*" add "19 Ill.2d 76,"
12. A-11, line 16, change "if" to "of"
13. A-12, line 3, change "449" to "448"
14. A-12, line 14, after "deducted" add the following: "from rate base. We have no quarrel with the cases cited by the"
15. A-14, line 3, change "premises" to premise"
16. A-16, line 21, after "Comm'n" add "23 Cal.3d 470, 153 Cal Rptr. 10,"

17. A-16, line 21, change "591 F.2d 34" to "591 P.2d 34"

18. A-18, line 12, change "benefits" to "benefit"

19. A-19, line 15, after "*Energy*" add "*Regulatory*"

20. A-19, line 18, change "(1971)" to "(5th Cir. 1971)"

APPENDIX II

Witness Bradley R. Lewis Recalled To The Stand.

Deferred State Income Taxes Issue:

Direct Examination By Mr. England:

Q. Would you state your name for the record, please.

A. Bradley R. Lewis.

Q. And, Mr. Lewis, you have previously testified under oath in this proceeding, have you not?

A. Yes, sir.

Q. And you realize you are still under oath at this time?

A. Yes, sir.

Mr. England: I tender the witness for cross-examination.

Cross-Examination By Mr. Ragsdale:

Q. Mr. Lewis, I direct your attention to Item No. 15 on Page 5 of the Hearing Memorandum on the subject of Deferred State Income Taxes. Can you briefly describe the differences between flow-through and normalizing income taxes?

A. Yes, sir. Any item in question produces an associated tax savings. This tax savings is realized by the Company immediately when they file their return with the Federal Government.

The question is whether to pass this tax savings through the income statement to the customer immediately or to defer it or normalize it over a period of years.

Q. And now does the Staff support normalization of deferred Federal income taxes due to accelerated depreciation?

A. Yes, sir.

Q. And does the Staff sometimes oppose normalization in other items, for instance, payroll taxes capitalized?

A. Yes, sir.

Q. Now, how does the Staff treat investment tax credits, are those normalized generally?

A. Yes, sir.

Q. And in particular, post 1971 additions are normalized, is that correct?

A. Yes, sir.

Q. Can you tell me why, in some instances, the Staff opposes normalization on some items and not on other items?

A. The Commission has ruled that it would grant normalization on a case-by-case basis. It has been the policy of the Staff not to oppose this authorization.

The Commission, in the last rate case, 18, 314, granted Union Electric normalization of the questioned items.

Q. Can you recollect the Staff ever opposing normalization of accelerated depreciation for Federal income tax purposes?

A. Not in a major case.

Q. And do you know why that would be? Do you know of any bar—

A. I would say the main reason is because the Commission has authorized it.

Q. And are you aware of any language in the tax law that perhaps has encouraged the Commission to normalize these items?

A. I am aware of the existence, although I must admit I have never read it.

Q. It is your belief that for Federal income tax purposes, there is a different treatment for investment tax credit and accelerated depreciation because of the language in the tax law, than there are for items such as payroll taxes normalized?

A. Would you repeat that?

Q. Is it your belief or do you have a knowledge that there are, perhaps, there is language in the tax law that would lead to normalization of investment tax credit and accelerated depreciation that does not exist in regards to other items such as payroll taxes, capitalized?

Mr. Smith: Your Honor, I am going to object to this. I think we are asking this Accountant to give us legal conclusions, to interpret tax laws for us.

Mr. Ragsdale: I was generally asking his information about the tax law, that's true, I am not asking whether it is correct.

Examiner Reimnitz: I think he can answer that question. It will be overruled.

Witness Lewis: I would repeat my answer before by saying that I am aware of the existence of that, but I have never read it myself.

By Mr. Ragsdale:

Q. Is normalization of taxes similar to, perhaps can be characterized as collection of taxes that will be payable by the Company to the taxing authorities sometimes in the indefinite future?

A. Not at all.

Q. Could you tell me where that statement is incorrect?

A. Normalization and flow-through, to the best of my knowledge, doesn't affect taxes payable. The current taxes payable is the same, it is how this benefit is flowed to the customers.

Q. I understand. What I am talking about is the collection of expenses that would be associated with those taxes for rate-making, now, would normalization, it may be described as the Company collecting those tax expenses from the ratepayers that it will not incur in the immediate future, or during the test year?

A. The way you have phrased that, I really don't agree with you.

Q. Does not normalization increase the Company's tax expense for rate-making purposes over what it actually pays the taxing authorities?

A. The total income tax expense is increased.

Q. Does normalization create a tax expense for rate-making purposes that exceeds the Company's actual tax liability to the taxing authorities?

A. In most cases total income tax will exceed current income tax, I think I would say yes.

Q. And does this create a positive cash flow for the Company?

A. Yes, sir; it is increased.

Q. And for each dollar of increased cash flow to the Company from normalization, does it require $2 from the customer in his rates?

A. Yes, sir.

Q. Does the effect of normalization provide the Company a method of raising capital?

A. I question the word "raising" but to have additional cash.

Q. And cash could be equated to capital?

A. Well, whether you say it's intentional or not, I think it stems back to the items which create the deferral, and I don't think they raised those.

Q. I didn't mean to say intentional, I said, is the effect of normalization the creation of additional capital for the Company?

A. Additional cash.

Q. Now, for the Company to get a million dollars of cash or capital through normalization, it requires $2 million in rates, is that correct?

A. Yes, sir.

Q. Do you know what the cost would be to the Company if they were to go into the capital market, the external capital market to raise this million dollars?

A. I can't give you an exact figure. I would say my nearest guess would be eight and three-quarters or nine percent, but that's just an estimate. That's a long-term debt.

Q. A long-term debt. So the interest costs would be something less than $90,000?

A. For a million dollars?

Q. For a one-year period?

A. Yes, sir.

Q. Now, if items are flowed through, then the tax expense for rate-making purposes would be identical to the tax expense appearing on the Company's tax returns?

A. If we assume the same adjustments to related expenses and revenues.

Q. And can you tell me how much deferred State income taxes were normalized by the Company in the test year, in regards to the Missouri operations?

A. I have that information, but it is not split in the State income taxes. I can get that for you.

Q. Can you get that for me and provide it to me on the record at a later time?

A. Yes, sir.

Mr. Ragsdale: I believe that concludes my questions, Mr. Examiner.

Mr. England: May I ask you, Mr. Ragsdale, what your last question was, for the purposes of supplying you with an answer later?

Mr. Ragsdale: I would like to know the deferred State income taxes normalized that would be allocated to Missouri in the test year.

Mr. England: Thank you.

Mr. Ragsdale: I did say State income taxes, didn't I?

That concludes my questions.

Examiner Reimnitz: Mr. Liberman.

Cross-Examination By Mr. Liberman:

Q. Mr. Ragsdale's questions seemed to cover Item 15 and 16 both, to some extent, are we just on 15 now? I just, this Item 15, Deferred State Income Taxes, can you tell me briefly what those items are? Is this just one item of State income tax or is it different kinds of normalization for, say, depreciation or payroll taxes, or other taxes? Is there any exhibit that shows me that?

A. None; no Staff exhibit. In my opinion, State income taxes is considered in all deferrals. Would you like to know which items are deferred? Would that help you?

Q. Yes, maybe that's what I am asking you.

A. Okay. Investment tax credit, the portion exceeding four percent.

Q. How much is that total investment tax credit for the tax year?

A. The Missouri portion, as adjusted, is $6,911,280.

Q. Is that the 11 percent allowed under the current tax law, or is it 10 percent?

A. That's four to 10 percent, sir.

Q. And there is another additional investment tax credit allowed, and I guess my question is then, is that involved in this case, or does the Company not take it?

A. I want to correct my last statement, it's four to 11 percent. cent.

Q. That last percent involves companies with plans, doesn't it, to some extent?

A. That's called employees' stock ownership plan, the additional one percent.

Q. Is there an expressly identifiable deferred income tax attributed to that?

A. Yes, there is. As I understand it, the Company is allowed an additional one percent investment tax credit and this one percent is turned around and distributed to the employees through a stock ownership plan.

Q. And how much is that?

A. What's the total?

Q. The dollar figure for the test year.

A. Okay; the total Company is $1,742,000. That's the total Company—you would have to multiply that by 72.85 to get the Missouri portion.

Q. Then that's part of that six million nine hundred eleven?

A. Yes, sir.

Q. Now, what I am not clear about still is how that relates to Missouri income taxes.

A. How does it relate?

Q. Yes; you indicated that that was an item, it was an item of deferred Missouri income taxes relating to this, as I understood you?

A. Yes, sir.

Q. What is the—number one, how much is that item, if you have an idea?

A. You have just heard it, sir.

Q. That's the Missouri tax item, that six million, or is it US?

A. I was talking about the employees' stock ownership plan.

Q. Right.

A. That is a portion of the previous figure. The first figure I gave you was the $6 million?

Q. Right.

A. That includes the Missouri portion of 1,742,000.

Mr. Smith: Can I ask a clarifying question?

Mr. Liberman: Yes.

Mr. Smith: Is that Federal, that six million dollars, is it Federal investment tax credit?

Witness Lewis: Yes, sir.

Mr. Smith: There is no state investment tax credit, is there?

Witness Lewis: No, sir.

Commissioner Jones: I think what he is getting at is how do all of these deferrals impact on the Company's State tax liability.

Mr. Smith: I think Mr. Liberman asked you both State and Federal.

Witness Lewis: Oh, I am sorry. I thought that's what you were asking, the Federal. Do you want to start over?

By Mr. Liberman:

Q. Well, I think we have got the Federal investment tax credit and what I want to ask you is how that relates to a deferred State income tax, or if it does? I understood your testimony to be that it did.

A. Excuse me. There is no investment tax credit for the State.

Q. All right. Let's get back to the deferred State income taxes, what are those?

A. Well, the Company provides separately, in the case of accelerated depreciation, they have a deferral for Federal and State. As far as my knowledge goes for the rest of the items, they have a 49.5 tax rate, and that is broken down into a Federal portion and a State portion. I don't have those figures broken out currently. They are just deferring them at a certain rate, which is 49.5.

Q. And then a certain portion of that is Missouri?

A. The State portion, yes.

Q. Okay. Could we just then list those, accelerated depreciation is done on a different basis than that, is that what you are saying?

A. It was just set out separately in my work papers.

Q. Why don't I get that?

A. I don't have it available right here.

Q. Okay. I would like that, if you can get it, for the test year, for the Federal and the State?

A. Yes, sir; that's the same information Mr. Ragsdale has requested.

Mr. Ragsdale: I didn't request anything for the Federal accelerated depreciation.

Witness Lewis: You want all deferred taxes broken out, Federal and State, is that the idea?

Mr. Liberman: Yes.

By Mr. Liberman:

Q. What I would like to know right now briefly is what other items we have under the 49.5.

A. Okay. Items that are capitalized per books, but are expenses for tax purposes, there are several of these items.

Q. Whatever comes under deferred.

A. I am just listing these. Repair allowance is one, expenses capitalized, which includes various expenses, pensions, payroll taxes, real estate and personal property taxes, sales and use tax, allowance for funds used during construction, the debt component there.

Q. Have you got a figure for each of those?

A. I have it for both Federal and State, for total company. I do not have the Missouri portion of each one.

Mr. Liberman: Okay.

Mr. England: Excuse me, Mr. Liberman, I am not sure, did you want the total or do you want the Missouri and the Federal, and I think we would have to provide that to you at a later time.

Mr. Liberman: Well, if he can provide it at a later time, I think it would save time for everybody to just do it that way.

Mr. England: We will provide you with that at a later time.

Mr. Liberman: And that will be broken down between Federal and State?

Mr. England: That's correct.

By Mr. Liberman:

Q. Can I just briefly go over these categories to see what they are, repair allowance, do you know what the consists of?

A. In previous years there has always been a controversy between corporations and the IRS as to the question of whether an item should be capitalized or whether it should be expenses.

Union Electric, in this particular case, has this problem, especially in the transmission and distribution area, in the small expenditures. Their repair allowance, briefly, allows Union Electric to capitalize, per books, the dollars in the standing work orders dealing with transmission and distribution, plant, while expensing for tax purposes an amount for your tax return.

So this is, once again, an item capitalized per books and expensed for tax purposes.

Commissioner Jones: And they don't recover any depreciation on that, as far as IRS is concerned, later on?

Witness Lewis: Yes, sir; it changes the tax and book basis, just like all of the other similar items do.

By Mr. Liberman:

Q. Well, I am still not exactly clear, most of these normalized expenses are a situation where—I see, they are collecting the tax now, but not paying it until later? What is the expense capitalized account that you just mentioned?

A. That various expenses capitalized, for the moment escapes me. It's a very minor amount and I will get that information for you later.

Q. Okay. The next one you mentioned was pensions, will you explain the nature of the tax deferral?

A. The same nature, items, pensions, pension expense associated with construction, it is capitalized per books while expensed for tax purposes. All of these items would have to be associated with construction because they are capitalized.

Q. All right. The payroll taxes too, that is simply the payroll taxes associated with construction?

A. Yes, sir.

Q. And the real estate and personal property, are those also associated with construction?

A. The same example, sir.

Q. Can you explain to me how real estate taxes are associated with construction?

A. Just because something is not in service doesn't mean the Company doesn't pay property taxes on it. In general, the assessment is usually half of the normal assessment, as if it were a plant in service, but they do pay property taxes. These are capitalized per books and expensed for your tax return.

Q. Now, this is not tax on land, is it? This is tax on construction in progress?

A. It is on land.

Commissioner Jones: It would be all property taxes they would pay on any construction project?

APPENDIX III

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

Case No. ER-77-154

In the matter of Union Electric Company of St. Louis, Missouri for authority to file revised tariffs reflecting increased rates for electric service provided to customers in the Missouri service area of the Company.

MOTION FOR REHEARING

Intervenor Utility Consumers Council of Missouri, Inc. moves the Commission to rehear this matter and reconsider its order for the following reasons:

* * *

7. The Commission erred in allowing the Company to normalize taxes because

a. taxes are an expense and to the extent that expenses are allowed in rates when there is no such expense, the Commission violates its statutory and constitutional duty to the ratepayers

b. it is untrue and unsupported by evidence or law that the Company's anticipated decline in construction will ever reach a point that it will not be able to replace existing facilities with newly depreciable facilities. The deferral of taxes created by accelerated depreciation will continue not only while the Company grows but so long as it remains constant in size and makes normal replacement of worn-out facilities. Only in the event that sales decline substantially will it ever be in a position of where there is a net of

tax depreciated items over newer not yet entirely depreciated items. The occurrence of this event is extremely unlikely in light of the evidence on which the Commission is allowing a rate of return sufficient to attract capital allegedly necessary for construction. Even if this event happened there would be no additional tax liability because the Company would be suffering severe losses, and would not need the depreciation deductions to avoid taxes.

c. the federal tax code did not require the normalization of accelerated depreciation tax savings, but at most prohibited a switch back to flow-through after a normalization method was elected. If the Company made such an election, the Commission is not bound by it.

d. the Congress does not have the power to compel a particular rate-making decision by this Commission and to the extent that any tax law of Congress does so, it is unconstitutional.

e. the fact that the Company may lose a deduction altogether does not justify the Commission in saddling the ratepayers with the expense, and the announcement and application of such a principle violates the statutory and constitutional duties of the Commission to set fair rates in this proceeding.

f. it is not correct that construction expenses are recognizable for taxing purposes in the year of expenditure. In most instances construction expenses must be capitalized, and no deduction is allowed. Thus there is no tax benefit associated with such expenses except depreciation which starts to occur when the construction is completed.

g. to the extent that the Company is allowed tax deductions for tax expenses related to construction and other

Schedule M deductions, these benefits should be passed on to the ratepayers in the year received, because the ratepayers are the ones for whom the tax collecting governments are collecting and spending the taxes in question.

Furthermore it is illusory to attempt to match such tax-savings to particular expenditures which may be capitalized, because a company's total income taxes are dependent on the interaction of income and expenses for a particular year and the effect in a future tax year may not in any way match the effect in a current tax year.

In addition ratepayers in the current year (or test year) are asked to bear a certain share of the costs of future construction by providing a rate of return sufficient to raise the necessary capital for such construction. This is particularly true where a large and increasing part of construction expenses are to be paid for by funds generated internally. To this extent the current ratepayers are entitled to the current tax-benefits even if you can meaningfully say that such benefits are related to future rate base items.

The denial of such tax benefits to current ratepayers forces them to pay expenses related to construction work in progress which is not yet in the rate base in violation of Proposition I. Similarly the normalization of Investment Tax Credit requires ratepayers to pay for non-used or useful property in violation of R.S.Mo., Sec. 393.135.

Respectfully submitted,

/s/ Samuel H. Liberman
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Attorney for U.C.C.M.

APPENDIX IV

IN THE CIRCUIT COURT FOR THE CITY [SIC] OF COLE
STATE OF MISSOURI

No. 30233

State Of Missouri, *ex rel.*
Utility Consumers Council Of
Missouri, Inc.
Petitioner

v.

Public Service Commission
Of Missouri and Union
Electric Co.
Respondents

NOTICE OF APPEAL TO MISSOURI COURT OF APPEALS KANSAS CITY DISTRICT

Notice is given that Relator Utility Consumers Council of Missouri, Inc. appeals from the judgment entered in this action on the 31st day of May 1979 in the Circuit Court of Cole County, 19th Judicial Circuit, Division one, by James T. Riley, Circuit Judge.

JURISDICTIONAL STATEMENT

This is an appeal from a judgment of the Circuit Court affirming a Report and Order of the Public Service Commission of the State of Missouri pursuant to a Petition for Review thereof filed in accordance with Sec. 386.510, R.S.Mo. 1969. *This appeal does not involve the validity of a treaty or statute of the United States* or of a statute or provision of the constitution of the state, the construction of any revenue law or the title to any state office. The appeal is within the general jurisdiction of the Missouri Court of Appeals. Article V, Section 3, Constitution of Missouri, as amended 1976. (Emphasis added by Respondents)

A cost bond in the amount of $500.00 is filed herewith. A request for preparation of transcript has been made to Ms. Marilea Stadler, Court Reporter for Division one of the Circuit Court of Cole County.

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Attorney for Petitioner

Dated: June 12, 1979